

# **US-CHINA OIL and GAS INDUSTRY FORUM**

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## **Favorable Regulatory Policies That Promote Natural Gas Development**

**Ken Thompson, Executive Vice President, ARCO**

Forum participants:

It is an honor to be addressing this forum on the topic of Favorable Regulatory Policies That Promote Natural Gas Development. ARCO has been actively engaged in China since 1979, and signed the very first Production Sharing Contract with CNOOC in 1982. We are now involved in numerous upstream and downstream enterprises in China, and have benefited greatly from the growth, stability and strong relationships that have come to symbolize the Chinese economy.

I believe it was the famous Chinese philosopher, Lao-tze, who is credited with having inspired Adam Smith in formulating the laissez-faire principles of a market based economy. It is a tribute to the Chinese people that these principles were subsequently recognized in the West by the late 18<sup>th</sup> century and are now being incorporated throughout the globe.

One of the more recent and highly successful demonstrations of these free market principles was the founding of APEC and the endorsement of the Natural Gas Initiative by all of its members last year, including China and the United States. A background paper on APEC and the evolution of the Natural Gas Initiative is included in my report. For today, however, I want to acknowledge China's role in the Natural Gas Initiative and demonstrate how that can form the basis for implementing reforms that will promote the further development of the natural gas industry in China and substantially increase direct foreign investment in China.

### **China's Role in the Natural Gas Initiative**

Formulated and supported the Natural Gas Initiative:

- Energy Working Group (EWG)  
State Development and Planning Commission (SDPC)

Advanced the NGI implementation plan at the Oakland meetings in April 1999:

- DOE Investment Workshop  
Included representatives from China
- Business Network to the APEC Energy Working Group  
China National Offshore Oil Corporation (CNOOC)

- Ministry of Electric Power
- Energy Working Group Meeting  
State Development and Planning Commission

### **Oakland Meetings**

This past April In Oakland California, Government and Business representatives from the APEC economies gathered for several functions: an Investment Workshop, the inaugural meeting of the EWG Business Network, and an Energy Working Group meeting of government representatives. The final outcome of this meeting was formally stated by the Energy Working Group as follows:

- Based on the recommendations from the Investment Workshop and the Business Network, the EWG selected 10 priority policies from the 36 policies in the Natural Gas Initiative. The purpose of this prioritization is to concentrate on near term implementation. These priorities are as stated:

- 1 Establish stable, transparent, independently administered, predictable and non-discriminatory legal, fiscal, regulatory and trade regimes that will consider the interests of all participants in the natural gas sector.
- 2 Permit private (domestic and foreign) ownership of natural gas facilities, and the assignment of security interests in assets.
- 3 Establish stable, transparent and non-discriminatory project approval process.
- 4 Recognize that in the longer term incorporating full costs and benefits associated with energy projects will help promote sustainable development and acknowledge that this should be further examined with a view towards developing practical applications.
- 5 In the meantime, remove unnecessary barriers to natural gas utilization taking into account the environmental benefits of natural gas compared with other fossil fuels.
- 6 Permit required capital transfers and unrestricted repatriation of earnings.
- 7 Permit recovery of and return on investment in natural gas infrastructure projects.
- 8 Clarify the environmental standards, appropriate to the conditions of the project, applicable to gas infrastructure projects and enforce such standards on a non-discriminatory basis.

- 9                    Ensure transit rights for natural gas trade across borders.
- 10                  Remove subsidies (direct and indirect) for fuels competing with natural gas.

### **Toward a Favorable Investment Climate for Natural Gas**

In the past decade, with the market based principles espoused by the late Premier Deng Xiaoping, and more recently by President Jiang Zemin and Premier Zhu Rongji, China has made remarkable advances toward achieving the policy recommendations enunciated in the Natural Gas Initiative and the prioritized pronouncements from Oakland. As with the US approach to natural gas policies, there is always room to improve. The same applies to China.

Some suggestions as to how China can implement the ten prioritized policy recommendations from the Natural Gas Initiative are as follows:

- Provide for an open and transparent bid process on exploration and production licenses.
- Apply non-discriminatory policies to both foreign and domestic bidders.
- Allow market conditions to establish gas buyers and pricing.
- Permit equity investment in natural gas pipelines.
- Establish clear environmental standards on gas projects that are uniformly applicable.
- Remove subsidies on competing fuels.
- Invite the EWG Business Network to China for detailed discussions on how best to implement the ten policy recommendations.

### **Why is this important to China?**

- Provides growth opportunities in China, which translates to more foreign investment and jobs.
- Drives the effort toward a cleaner, environmentally preferred fuel source in China.
- Monetizes stranded gas assets.
- Allows for an infusion of new technologies for gas utilization.
- Helps meet China's growing energy demand, particularly in the power generation sector.
- Demonstrates a commitment to APEC and the Natural Gas Initiative.
- Strengthens China's position for WTO.

**Why is this important to the U.S. Government and Private Sector?**

- Provides growth opportunities for US companies in China.
- Drives the shift toward a cleaner, environmentally preferred fuel source in the Asia Pacific Region.
- Demonstrates the capabilities and potential of the combined efforts of government and the private sector.
- Allows U.S. companies to demonstrate their technology and expertise in a focused and realistic approach.
- Furthers the founding intent and mission of APEC.

Together we can chart a new course for open markets and expanded trade. By working toward implementation of the policy recommendations, the US and China will come to view the natural gas market in the same light. And when two nations share the same vision, peace and prosperity will inevitably prevail.

## **Background Paper on APEC and the Natural Gas Initiative**

by Ken Thompson

### **APEC Asia Pacific Economic Cooperation.**

**APEC was founded in 1989 as an open forum to promote trade and economic cooperation between member economies along the Pacific Rim.**

**APEC presently contains 21 members:**

**Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan, Thailand, United States, and Vietnam.**

### **Natural Gas Initiative (NGI)**

**In 1997, the Energy Ministers of the APEC member economies charged the Energy Working Group with developing the Natural Gas Initiative (NGI) for the purpose of promoting growth in natural gas development and infrastructure.**

**The NGI identified conditions that inhibited the acceleration of private sector investment in natural gas supplies, infrastructure and trading networks in the APEC Region, with special focus on Southeast Asia:**

- Lack of infrastructure.
- Absence of facilitating and predictable legal, regulatory and trade frameworks governing the natural gas sector.
- Absence of fiscal regimes that recognize risks to project sponsors and investors.
- Absence of open, transparent and competitive markets throughout the natural gas chain.
- Inefficient pricing of natural gas, including government price intervention and tax distortions.

**The NGI offers policy recommendations to promote the acceleration of investment in natural gas supplies, infrastructure and trading networks in the APEC region:**

- General policies to promote investment in and financing of natural gas supplies, such as permitting foreign ownership of gas facilities, providing non-discriminatory treatment of foreign companies and ensuring sanctity of contract.
- Policies to promote exploration and production of natural gas, such as permitting access to exploration acreage on a non-discriminatory basis,
- Policies to facilitate construction of natural gas infrastructure, by establishing transparent and non-discriminatory procedures for obtaining licenses to operate natural gas projects.
- Policies to facilitate development of domestic and cross-border trading networks for natural gas, such as ensuring transit rights for natural gas trade across borders.
- Policies to facilitate the development of markets for natural gas, such as allowing buyers and sellers to negotiate directly with each other and by removing subsidies for competing fuels.

**The APEC Energy Ministers endorsed the NGI in Okinawa on October 9, 1998.**

**APEC Leaders and Trade Ministers endorsed the NGI in Kuala Lumpur in November 1998.**

**Oakland Meetings (April, 1999)**

In April, 1999, Government and Business representatives from the APEC economies gathered in Oakland California for several functions: an Investment Workshop, the inaugural meeting of the EWG Business Network, and an Energy Working Group meeting of government representatives. Investment Workshop participants made several recommendations which were advanced by the Business Network before the Energy Working Group. The final outcome of this process was formally stated by the Energy Working Group. Those actions are as follows:

- Based on the recommendations from the Investment Workshop and the Business Network, the EWG selected 10 priority policies from the 36 policies in the Natural Gas Initiative in order to concentrate on near term implementation. These are as follows:
  - 1            Establish stable, transparent, independently administered, predictable and non-discriminatory legal, fiscal, regulatory and trade regimes that will consider the interests of all participants in the natural gas sector.
  - 2            Permit private (domestic and foreign) ownership of natural gas facilities, and the assignment of security interests in assets.
  - 3            Establish stable, transparent and non-discriminatory project approval process.
  - 4            Recognize that in the longer term incorporating full costs and benefits associated with energy projects will help promote sustainable development and acknowledge that this should be further examined with a view towards developing practical applications.
  - 5            In the meantime, remove unnecessary barriers to natural gas utilization taking into account the environmental benefits of natural gas compared with other fossil fuels.
  - 6            Permit required capital transfers and unrestricted repatriation of earnings.
  - 7            Permit recovery of and return on investment in natural gas infrastructure projects.

- 8 Clarify the environmental standards, appropriate to the conditions of the project, applicable to gas infrastructure projects and enforce such standards on a non-discriminatory basis.
  - 9 Ensure transit rights for natural gas trade across borders.
  - 10 Remove subsidies (direct and indirect) for fuels competing with natural gas.
- The EWG will communicate the ten priority policies to the Energy Ministers.
  - The EWG will establish a “Coordination Group”, with voluntary participation, to include members of both the EWG and the Business Network. The purpose will be to promote private sector investment in the natural gas chain. Tasks assigned to the Coordination Group are as follows:
    - 1 Develop an information base on markets and institutions.
    - 2 Evaluate the economic impact of gas industry development.
    - 3 Create a self-assessment “check list” against which each economy could consider the degree to which these ten policy principles are in place.
    - 4 Review regulatory policies and reforms.
    - 5 Develop the capacity to track and evaluate foreign direct investment in the gas sector, in a non-critical manner.
    - 6 Prepare an APEC Best Practices Manual for natural gas.
    - 7 Conduct other studies or workshops on issues such as the Mexican reform model, specific gas projects, and appropriate taxation regimes.
    - 8
  - When invited by member governments, members of the EWG Business Network could visit APEC economies to engage in regular discussion on approaches to implement the Natural Gas business priorities.
  - Suggest pioneer projects to serve as case studies to demonstrate the impact of implementing the ten Natural Gas business priorities. This is not intended to create new projects or champion some projects over others. The purpose would be to use “real world” projects and reforms as a benchmark against the ten business priorities.
  - The Business Network shall undertake an annual follow up of progress in implementing the decisions taken on the Natural Gas recommendations and furnish reports to the EWG and Energy Ministers when they meet.
  - The EWG will develop an action strategy on Natural Gas based on the agreed recommendations from the Investment Workshop and from the Business Network